BRAD D. BRIAN (State Bar No. 079001)
Brad.Brian@mto.com
RICHARD E. DROOYAN (State Bar No. 065672)
Richard.Drooyan@mto.com
LAURA D. SMOLOWE (State Bar No. 263012)
Laura.Smolowe@mto.com
MUNGER, TOLLES & OLSON LLP
355 South Grand Avenue
Thirty-Fifth Floor
Los Angeles, CA 90071-1560
Telephone: (213) 683-9100
Facsimile: (213) 687-3702

Attorneys for Defendants
Robert A. Siravo and Thomas E. Swedberg

UNITED STATES DISTRICT COURT

CENTRAL DISTRICT OF CALIFORNIA

NATIONAL CREDIT UNION ADMINISTRATION BOARD AS CONSERVATOR FOR WESTERN CORPORATE FEDERAL CREDIT UNION,

Plaintiff,

vs.

ROBERT A. SIRAVO, TODD M. LANE, ROBERT J. BURRELL, THOMAS E. SWEDBERG, TIMOTHY T. SIDLEY, ROBERT H. HARVEY, JR., WILLIAM CHENEY, GORDON DAMES, JAMES P. JORDAN, TIMOTHY KRAMER, ROBIN J. LENTZ, JOHN M. MERLO, WARREN NAKAMURA, BRIAN OSBERG, DAVID RHAMY and SHARON UPDIKE,

Defendants.

CASE NO. CV10-01597 GW (MANx)

REPLY MEMORANDUM OF DEFENDANTS SIRAVO AND SWEDBERG IN SUPPORT OF MOTION TO DISMISS WITH PREJUDICE COUNTS ONE, TWO, THREE AND FOUR OF FIRST AMENDED COMPLAINT PURSUANT TO FED. R. CIV. P. 129(B)(6)

Judge: Honorable George Wu
Date: December 20, 2010
Time: 8:30 a.m.

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I. INTRODUCTION

The crucial fact at issue in Defendants Siravo's and Swedberg's (collectively, "Defendants") Motion to Dismiss Counts Three and Four of the First Amended Complaint (the "FAC") is *undisputed*. In proposing changes to WesCorp's Supplemental Executive Retirement Plans ("SERP"), Defendants fully disclosed to WesCorp's Board of Directors ("the Board") the precise nature of the proposed changes to the SERP calculation formula, and the financial impact of the proposed changes. Notwithstanding Plaintiff's overtones to the contrary, the FAC acknowledges, as it must, that it was no secret that the proposed SERP amendments to include bonuses and incentive pay in the definition of compensation and to increase the tax gross-up to the correct amount would increase the supplemental retirement benefits that Defendants and other WesCorp executives would receive upon their retirements from the company. There is nothing remarkable, much less sinister or conspiratorial, about any of this, and none of it forms the basis for claims of fraud or a breach of fiduciary duty.

That Defendant Swedberg characterized the changes as "administrative" rather than "substantive" is just that ─ a non-actionable characterization or opinion that was entirely immaterial. It simply cannot form the basis of Plaintiff's claims where, as here, the Board was fully informed about the nature of the changes and the financial implications.

Without a real leg to stand on, Plaintiff's Opposition relies upon new theories and allegations not present in the FAC. Plaintiff must, however, accept the allegations as pled for purposes of opposing a motion to dismiss, and it cannot rely upon allegations not in the FAC. Although these new allegations may be a reason for the Court to grant Plaintiff leave to amend the complaint (even though they are contradicted by documents they reference), they are not grounds for defeating the motion itself.

Finally, Plaintiff erroneously claims that the business judgment rule does not apply to Siravo's activities that are the subject of Counts One and Two because he was not a director. The statute that Plaintiff cites makes it clear, however, that where, as here, an officer's activities are indistinguishable from those of directors, he is entitled to the protection of the business judgment rule. Accordingly, Counts One and Two should also be dismissed.

II. ARGUMENT

A. The First Amended Complaint Does Not State A Claim for Fraud Or Breach Of Fiduciary Duty

1. Plaintiff's Claims Are Based Entirely Upon The November 2, 2007 Memorandum Attached As Exhibit 1 To The FAC

The crux of Plaintiff's claims for both fraud and breach of fiduciary duty[1] is that Defendants made a material misrepresentation in a memorandum that Swedberg sent to WesCorp's Chairman Robert Harvey on November 5, 2007. (FAC, ¶¶ 93-98, Ex. 1.) In reliance on this memorandum, which was "provided to the board's executive committee (and possibly the board as a whole)," the Board allegedly "approved the amendments to the SERPs and permitted the increased SERP payments to Siravo and Swedberg." (FAC ¶¶93, 134.)

Although the FAC references other documents, they are not the basis for Plaintiff's claims. In summarizing the allegations in the FAC, Plaintiff discusses a PowerPoint presentation that Swedberg prepared, which allegedly contained "false and misleading" statements, (Opp. at 4 (citing FAC ¶ 90)), but it never mentions the

[1] Plaintiff's Opposition concedes that its fraud and breach of fiduciary duty claims rise or fall together. (Opp. at 9 & n.3.) (acknowledging that "fiduciary duty underlies all of the claims against Siravo and Swedberg relating to the SERP amendments" and agreeing that "if [they] prove that their disclosures to WesCorp's board fully satisfied their duty of candor and full disclosure, . . .those disclosures would not be actionable as fraud").

PowerPoint again. That is because the FAC does not allege that the Board or its representatives ever relied on the PowerPoint. *See Perlas v. GMAC Mortg., LLC*, 187 Cal. App. 4th 429, 434, 113 Cal. Rptr. 3d 790, 794 (2010) (reliance is an element of fraud); *Pelligrini v. Weiss*, 165 Cal. App. 4th 515, 524, 81 Cal. Rptr. 3d 387, 397 (2008) (damages *caused by* the breach is an element of breach of fiduciary duty). Indeed, according to the FAC, the Chairman of the Compensation Committee John Merlo allegedly told Swedberg to replace the PowerPoint with a short memorandum. (FAC ¶ 91.)[2]

With respect to the drafts of the "short memo" that Plaintiff alleges in the FAC were "false," (FAC ¶ 92), Plaintiff asserts in its Opposition that they "led to [John Merlo and Robert Harvey's] support of the final resolution and approval of the SERP amendments." (Opp. at 18.) But the FAC *does not make those allegations.* Indeed, the FAC does not even allege that anybody ever saw the drafts, much less relied upon them.

As a matter of law, this Court may not consider these new allegations here. *Broam v. Bogan*, 320 F.3d 1023, 1026 n.2 (9th Cir. 2003) ("In determining the propriety of a Rule 12(b)(6) dismissal, a court *may not* look beyond a complaint to a plaintiff's moving papers, such as a memorandum in opposition to a motion to dismiss" (citation omitted)). Thus, Plaintiff's argument must focus entirely upon

[2] Had Plaintiff actually alleged that anyone had relied on the PowerPoint presentation, Defendants would have attached it to their Motion to Dismiss and demonstrated that it contains no misrepresentations. *Sprewell v. Golden State Warriors*, 266 F.3d 979, 988 (9th Cir. 2001) ("The court need not, however, accept as true allegations that contradict matters properly subject to judicial notice or by exhibit.") Should the Court allow Plaintiff to amend, Defendants intend to do just that. By way of a proffer, the PowerPoint explains that the "28% shortfall" occurred because executives had in the interim begun to receive bonuses and incentive pay. As this additional income was not accounted for in the definition of compensation, the SERPs "no longer produce[d] 48% income replacement." Similarly, in context, the PowerPoint explains that the reason for changing the gross-up was based on "then current thinking." Since the program was initially developed, other plans had determined that a 67% tax gross-up was more appropriate and begun to use that number.

the November 2, 2007 memorandum attached as Exhibit 1 to the FAC. (*See e.g.*, Opp. at 12, 14, 16.)

2. The Purported Misrepresentations In The November 2 Memorandum Are Neither Misleading Nor Material

Plaintiff must prove that Defendants made a misrepresentation and that the misrepresentation was material. *See Levine v. Blue Shield of California*, 189 Cal. App. 4th 1117, --- Cal. Rptr. 3d ----, 2010 WL 4369797, at *5 (Cal. Ct. App. 2010) (element of fraud is that defendant "must have concealed or suppressed a material fact"); *Neel v. Magana, Olney, Levy, Cathcart & Gelfand*, 6 Cal. 3d 176, 189, 98 Cal. Rptr. 837, 845 (1971) (fiduciaries have a duty to disclose all facts "which materially affect [the beneficiary's] rights and interest"). The fundamental problem for Plaintiff is that Exhibit 1 to the FAC demonstrates conclusively that none of Defendant Swedberg's representations were either misleading or material given the information that he provided about the nature and financial impact of the changes. *See In re Bare Escentuals, Inc. Sec. Litig.*, No. C 09-3268 PJH, 2010 WL 3893622, at *10 (N.D. Cal. Sept. 30, 2010) (on a motion to dismiss "the court may consider exhibits attached to the complaint" (citation omitted)).

The allegations in the FAC do not support a claim that Defendants Siravo and Swedberg misrepresented anything to the Board. At best, Plaintiff has alleged conclusory allegations of wrongdoing along with representations by Defendant Swedberg that are transparently immaterial. A complaint fails to state a claim under such circumstances. *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1949-50, 173 L.Ed. 2d 868, 894 (2009) (courts, "draw[ing] on . . . judicial experience and common sense," must deny complaints containing only "conclusory statements" and the "mere possibility of misconduct").

According to the FAC, after meeting with Robert Harvey and John Merlo, on November 5, 2007, Defendant Swedberg, "with [Defendant] Siravo's concurrence,"

sent a memorandum to Harvey that provided the information he had "requested regarding two suggested changes to the CEO Supplemental Executive Retirement Plan." (FAC ¶¶ 88, 93, Ex. 1.) The document "recommend[s]" that (1) "[t]he CEO's bonus and incentive pay be included in the benefit calculation"; and (2) the Board "[c]hange the tax gross-up calculation to utilize the divisor of (.60%) versus the current multiplier of (1.40%)," which "results in the correct tax gross-up amount." (FAC Ex. 1.) Of paramount importance, Defendant Swedberg explicitly explained in the memorandum that the changes would result in the CEO receiving $7.412 million instead of $4.863 million. (*Id.*)

Plaintiff *concedes* that Defendant Swedberg disclosed the most critical information (amount of benefit increase and substantive nature of the changes) in the memorandum to the Chairman Harvey, yet insists that the Board was nevertheless misled because Defendants allegedly (1) mischaracterized the change as "administrative" rather than "substantive;" and (2) gave the Board a "reason for the change" that was "false and misleading. (Opp. at 13-14.) These arguments should be rejected out of hand.

For the reasons articulated in the Motion, the characterization of the suggested changes as "administrative" rather than "substantive" is a non-actionable opinion. (Mot. at 8-9.) Further, as the FAC itself makes clear, the characterization of the change is not material. *See Levine*, 2010 WL 4369797, at *5; *Neel*, 6 Cal.3d 176 at 189. The FAC proves this point by alleging that these were "substantive changes intended to nearly double the SERP benefit." (FAC ¶ 94.) Yet Exhibit 1, on its face, *discloses* that the changes would nearly double the SERP benefit. If, as explained in the FAC itself, the import of the "administrative" versus "substantive" characterization is the extent of the increase in benefits, that is precisely the information that Defendant Swedberg conveyed in Exhibit 1. Swedberg's characterization of the change as "administrative" could not possibly be material where, as here, he fully described the "substantive" financial impact of the change.

See Restatement (Second) of Torts § 538, com. e (1977) (stating that a fact is not material as a matter of law "if the fact misrepresented is so obviously unimportant that the jury could not reasonably find that a reasonable man would have been influenced by it"); *see also Quan v. Computer Sciences Corp.*, 623 F.3d 870, 886-87 (9th Cir. 2010) (rejecting breach of fiduciary duty claim in ERISA action where purported misrepresentations about "pricing of stock options at 100% of market value," had little financial impact and therefore were not material as a matter of law).

Plaintiff's claim that Defendants misrepresented the reason for the changes cannot survive either. Defendant Swedberg recommended that the Board include bonus and incentive pay in the definition of compensation to conform the plan "with the intent of the program when it was initially developed," which was to pay WesCorp's retiring executives at a replacement rate of 48% of their compensation. (FAC Ex. 1.) This was a true statement; in the intervening years since the first SERP was adopted, WesCorp's executive compensation had changed from a salary-based compensation system to a salary-plus-bonus-and-incentive-pay system. (FAC ¶ 84 & Ex. 1.) Swedberg also recommended to the Board that it change the "tax gross-up calculation" to achieve the "correct tax gross-up amount." Notably, Plaintiff does not dispute (either in the FAC or the Opposition) Swedberg's assertion that his proposed change results in the "correct" amount.

Plaintiff repeatedly asserts that Siravo and Swedberg concealed their "true intentions and reasons for the changes" (Opp. at 10-12, 14), which the FAC alleges "were simply intended to increase the size of the lump sum payment to Siravo." (FAC ¶ 87.) Through Exhibit 1, however, Defendant Swedberg explicitly told Chairman Harvey that the proposed changes to Siravo's SERP would increase Siravo's retirement payout by over $2.5 million. Quite obviously, a fundamental purpose of the change was to obtain a larger retirement pay-out for Siravo. Based

on Exhibit 1, the Board could not have been misled about the purpose (or impact) of the changes recommended by Swedberg.

Plaintiff also argues that Defendants committed wrongdoing because they "did not disclose that they had agreed to seek changes to each other's SERPs." (Opp. at 11.) But the Board separately decided the proposed amendments to the CEO SERP and the Executive SERP with a full understanding of the financial impact of the proposed changes. Without any material misrepresentations to the Board, that Siravo and Swedberg allegedly worked in concert to obtain the SERP changes is of no legal consequence.

3. The Purported Misrepresentations Compare Two Different Time Periods

Plaintiff concedes that the FAC allegations of misrepresentation improperly compares two different time periods, but claims (without any case citation whatsoever) that the difference is without consequence because the time periods were, allegedly, only four months apart. (Opp. at 16-17.) The FAC, however, *does not allege* that the intent of WesCorp in creating the original SERP in 2001 was the same (or even similar) as the intent of the parties in assenting to the Siravo SERP contract in 2002. Absent such an allegation, the FAC simply cannot use the intent of the contracting parties at the time the Siravo contract was negotiated in 2002 as a basis for showing that Swedberg's representations about WesCorp's intent in creating the original SERP in 2001 ─ an entirely different time period ─ were false. (FAC ¶ 96 & Ex. 1.) *See Quan*, 623 F.3d at 886-87 (rejecting breach of fiduciary duty claim in ERISA action based on alleged misrepresentations such as "a statement purportedly to the effect that [a] June [30] 2006 stock price drop was caused by 'the market, not [defendant]" because the statement actually referred to the market on June 15, not June 30); *see also Broam*, 320 F.3d at 1026 n.2 (plaintiff cannot create new allegations in an opposition brief).

4. The Complaint Does Not Allege A Claim For Constructive Fraud And Such A Claim Would Fail Regardless

Continuing to alter the FAC through its Opposition, Plaintiff now asserts that the FAC supports a claim for constructive fraud. (Opp. at 12.) The FAC makes no mention of such a cause of action, and for this reason alone it should be rejected here. Even if allowed, however, the claim adds nothing. In an action for constructive fraud, Plaintiff must still show reliance, damage *as a result* of the lack of disclosure, and a material failure. *The 1849 Condominiums Assoc., Inc. v. Bruner*, No. 2:09-cv-03339-JAM, 2010 WL 2557711, at *5 (E.D. Cal. June 21, 2010) (facts withheld must be material to support a constructive fraud claim); *Estate of Gump*, 1 Cal. App. 4th 582, 603, 2 Cal. Rptr. 2d 269, 282 (1991) (reliance and damage required for constructive fraud). As already explained, the FAC fails to state allegations sufficient to make out these contentions.

5. Plaintiff's New Argument That The Amended SERPs Used A Different Formula Than The Board Authorized Is Not Alleged in the Complaint

The assertion in the Opposition that the amended SERPs did not comply with the Board's resolution because they contained "a more generous formula" for calculating the SERP payments than the Board authorized (Opp. at 17) is likewise found nowhere in the FAC. Again, Plaintiff has cobbled together an entirely new allegation when faced with the inadequacies of its complaint. Defendants cannot defend themselves against such ever-changing accusations, which therefore should be rejected.

The FAC alleges that the Board adopted a resolution to approve the SERP changes based upon "the proposal outlined in the November 2 memorandum." (FAC ¶¶ 97-98.) That memorandum attached to the FAC as Exhibit 1 described changes that would result in an increased pay-out to Siravo of up to $7.412 million.

Yet the FAC then alleges that "[t]he amended Siravo SERP provided Siravo a larger *lump sum payment* than the board's resolution authorized" because Siravo was paid $6,881,401 million. (FAC ¶¶ 100, 102 (emphasis added).) As $6.8 million is clearly *less* than $7.4 million, not more, the FAC is at odds with its own Exhibit, and in such cases, the Exhibit trumps. *Sprewell*, 266 F.3d at 988.

Plaintiff does not address this problem at all in its Opposition. Instead, it forwards the entirely new allegation that the amended SERP allowed for a more generous *formula* than the Board authorized. Specifically, Plaintiff now claims that the Board authorized a formula based on WesCorp's Defined Benefit Plan ("DBP"), which used the "average of the employee's annual compensation over the prior five years," while the amended SERP "calculated compensation based on the *highest* annual compensation out of the prior three years." (Opp. at 7 n.2.) The FAC, however, alleges nothing of the kind.[3]

B. The Business Judgment Rule Applies To Siravo

Finally, the business judgment rule applies to Siravo with respect to his conduct that is the subject of Counts One and Two of the FAC because he was acting in a capacity indistinguishable from an uninterested director.[4] *See* Cal. Corp. Code § 7231(c) (any "person who performs the duties of a director" is entitled to the protection of the business judgment rule); *see also, e.g.*, *Official Comm. Of*

[3] Again, had Plaintiff actually made this allegation in the FAC, Defendants would have responded to it by attaching the DBP for the Court's review. Defendants proffer that the DBP, on its face, would contradict Plaintiff's representations. Specifically, Defendants would demonstrate to the Court that the "average compensation" referenced has no application to the SERP amendments. The Board resolution states that the new SERP should "[i]nclude salary *plus* bonus and incentive pay . . . to make it consistent with the compensation used in WesCorp's [DBP]." (FAC ¶ 99.) The DBP in fact defines "compensation" as "the total compensation we paid to you that is subject to federal income tax." In other words, the resolution sought to make the SERPs consistent with the DBP by including bonus and incentive pay. The "Average Compensation" referenced by Plaintiff for the first time in its Opposition relates to a definition of the "Normal Retirement Benefit," *not* the meaning of compensation in the DBP generally, as Plaintiff suggests.

[4] Defendant Siravo also incorporates the arguments set forth in the Reply Brief of the Director Defendants.

Unsecured ex rel. Lemington Home for the Aged v. Baldwin, No. 10cv800, 2010 WL 4275252, at *10 (W.D. Pa. Oct. 25, 2010) (holding that the business judgment rule protected officer defendants in the absence of allegations of bad faith or self dealing); *Matter of Munford, Inc.*, 98 F.3d 604, 611 (11th Cir. 1996) ("business judgment rule protects directors and officers from liability when they make good faith business decisions in an informed and deliberate manner").

Gaillard v. Natomas, 208 Cal. App. 3d 1250, 256 Cal. Rptr. 702 (1989), upon which Plaintiff relies, in fact supports Defendant Siravo's position. In *Gaillard*, shareholders brought a derivative action challenging "golden parachutes" and other benefits given to five inside directors as part of a merger. The inside directors had not voted on the benefits, but had drafted them and proposed them to the board. *Id.* at 1259-60. The inside directors argued that this self-interested activity was subject to the protection of the business judgment rule. The court rejected that claim because, in the context of a golden parachute, "[t]he inside directors . . . were not 'perform[ing] the duties of a director' . . . but were acting as officer employees of the corporation." *Id*. at 1265; *see also ViChip Corp. v. Lee*, 438 F. Supp. 2d 1087, 1099 (N.D. Cal. 2006) ("The business judgment rule can only be used where a fiduciary [officer or director] is demonstrated to have acted in an unbiased manner"); *In re Croton River Club, Inc*., 52 F.3d 41, 44 (2d Cir. 1995) ("It is black-letter, settled law that when a corporate director or officer has an interest in a decision, the business judgment rule does not apply").

Defendants do not dispute this proposition. Indeed, it is for this reason that Siravo does not claim the business judgment rule as a defense to the SERP claims in Counts Three and Four. There, Siravo was an interested officer who received a benefit from the decision of the Board. In that context, the *Gaillard* court's comment that "an officer-director might be liable for particular conduct because of his capacity of an officer, whereas the other directors would not" (208 Cal. App. 3d at 1265) fits perfectly. The Board's decision to approve the SERP amendments

might well be protected by the business judgment rule while Siravo's decision to propose them would not.

Counts One and Two, however, are wholly different. There is no allegation that Mr. Siravo had any responsibilities or took any action that would suggest his role was as anything other than that akin to an uninterested director. The FAC draws no distinction between his conduct and that of the other directors. In such a context, Siravo is a "person performing the duties of a director" and is therefore entitled to the business judgment rule.

III. CONCLUSION

Plaintiff's Opposition does not save the FAC, but rather creates new allegations and theories of liability not currently present. The FAC does not adequately allege fraud or breach of fiduciary duty. Further, Siravo is entitled to the protection of the business judgment rule. The Motion to Dismiss should be granted.

DATED: December 6, 2010

MUNGER, TOLLES & OLSON LLP
Richard E. Drooyan
Laura D. Smolowe

By: */s/ Richard E. Drooyan*
RICHARD E. DROOYAN

Attorneys for Defendants
ROBERT A. SIRAVO AND
THOMAS E. SWEDBERG